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Statement of

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Washington Office
Consumers Union

on

The State Of Competition In The Multichannel Video Industry

before

The Federal Communications Commission

on

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INTRODUCTION

Although policymakers have tried to promote competition to local cable monopolies, consumers continue to face excessive and abusive rate increases for cable services. Congress and the Federal Communications Commission (FCC) attempted to open up the cable market to competition from local telephone companies and eliminate significant barriers to competition from satellite and wireless video providers, but little has changed for the average consumer.

Just as the Bureau of Labor Statistics (BLS) announced the lowest inflation rate in more than a decade – less than 2 percent, cable companies jacked up rates: 7-10 percent in San Diego; 10 percent in Baltimore; 11 percent in Indianapolis; San Antonio and New York; 12 percent in Memphis and 10-15 percent around Boston.¹ Where is the cost-effective alternative to paying skyrocketing prices – rising much more than three times faster than inflation (see Figure 1) -- charged by the local cable monopoly?

Consumers Union² believes that the goals of the 1996 Telecommunications Act (1996 Act) can only be achieved by putting a lid on rates, cracking down on monopolistic practices and by promoting new alternatives to cable. To that end, we and the Consumer Federation of America recently asked the Commission to impose an immediate freeze on cable rates, as you did in a similar environment four years ago, and launch a full scale investigation on why consumers are getting gouged by the cable industry.³ Unless the FCC imposes a meaningful lid on cable rates and attacks the root cause of monopolistic excesses, consumers will face skyrocketing prices without adequate competitive alternatives.

I. CABLE'S HISTORY OF MONOPOLISTIC PRACTICES

In 1992, Congress told the FCC to impose stringent pricing, ownership and behavioral limitations on a cable industry that had reinforced its market dominance since being substantially deregulated in 1984.⁴ After six years of relaxed regulation, Congress found that:

¹ John M. Higgins, "Cable Ramps Up Rates," Broadcasting & Cable, Dec. 8, 1997.

² Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

³ Petition of Consumers Union, Consumer Federation of America to Update Cable Television Regulations And Freeze Existing Cable Television Rates, Before the FCC, MM Dkt No.'s 92-264, 265, 266, filed Sept. 23, 1997.

⁴ Cable Television Consumer Protection and Competition Act of 1992, (1992 Act), Public Law 102-385 102nd Congress, Oct. 5, 1992, 106 Stat. 1460, amending the Cable Communications Policy Act of 1984.

The average monthly cable rate has increased almost three times as much as the Consumer Price Index since rate deregulation. . .

(4) The cable industry has become highly concentrated. The potential effects of such concentration are barriers to entry for new programmers and a reduction in the number of media voices available to consumers. . .

(5) The cable industry has become vertically integrated; cable operators and cable programmers often have common ownership. As a result, cable operators have the incentive and ability to favor their affiliated programmers. This could make it more difficult for noncable-affiliated programmers to secure carriage on cable systems. Vertically integrated program suppliers also have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and programming distributors using other technologies.⁵

Immediately after passage of the 1992 Act, the FCC was an active advocate for the consumer in the arena of policing the cable television industry. The Commission imposed price limits on cable rates found to be "unreasonable," developed extensive rules to prevent cable companies from discriminating against unaffiliated video distributors and programmers, and established ownership limits designed to prevent further monopolization in the cable industry. The marketplace reaction to these steps was positive, from the consumer point of view. Consumers saved \$3-5 billion on their cable bills⁶ and the market began to open itself up to competition.

Unfortunately, after those initial successes, the FCC has virtually abandoned all efforts to police market abuses or challenge inflated cable TV rates. What happened to the goals set for the agency by Congress to reduce cable rates to a reasonable level and promote broad-based, head-to-head competition? Relaxed regulation has resulted in substantially higher rates and increased concentration of ownership.

II. INCREASED CONCENTRATION AND RATE HIKES

So what went wrong? The culprits here are plentiful. Cable, telephone and satellite companies exaggerated their desire and willingness to compete against each other. The FCC had to adjust to an expanded mission with numerous responsibilities foisted on it by the 1996 Act, and the deregulatory pressure from many in Congress contributed significantly to the agency's relaxation of cable regulations.⁷

⁵ 1992 Act, op.cit.

⁶ David Lieberman, "Industry argues for deregulation," *USA Today*, May 31, 1995; Statement of Reed Hundt, Chairman, FCC before the House Judiciary Committee, on the State of Competition in the Cable Television Industry, Sept. 24, 1997.

⁷ The FCC also appears to have perceived the Act's deregulatory thrust to mean that, as the original versions of S. 652 and H.R. 1555 indicated, Congress intended for the Commission to relax cable rate regulation as soon as possible. However in the Act's final version, Congress reinstated full Commission authority to regulate all

The time has come to do an inventory of the promises made by the cable industry in exchange for a deregulated environment. From the consumer's point of view, those promises have been broken and the FCC has done virtually nothing to hold the industry accountable. It is time for the Commission to address legitimate concerns about excessive cable rate increases and massive concentration of ownership by the largest cable companies. It is time for the FCC to take action, for the sake of the consumer, to set a new course for the marketplace. We believe the first step should be with a cable rate freeze.

Why a freeze? First look at the lack of competition. The numbers tell a sad story. The FCC's own market analyses show a few large cable companies dominate the ownership and distribution of cable programming:

Between 1995 and 1996, concentration of cable systems at the national level increased. . . . In the 1995 Report, we found that the four largest cable MSOs served 55% of all cable subscribers nationwide, with TCI (with a subscriber share of 26%), Time Warner (16%), Continental (7%), and Comcast (6%) being the four largest. In the past year, the percentage of cable subscribers served by the four largest MSOs has risen to 61.40%, with TCI (27.94%), Time Warner (18.94%), Continental/U S West (7.69%), and Comcast (6.83%) remaining the four largest. . . .

Overall, the size of vertically-integrated ownership interests has remained nearly the same. Cable MSOs, either individually or collectively, own 50% or more of 47 national cable programming networks, compared with 45 networks last year ...

Vertical integration continues to involve principally the largest cable system operators. The eight largest cable MSOs have a stake in 63 of the 64 vertically-integrated services, or in 98% of all such services.⁸

Competition is unlikely to develop in the current environment of consolidated ownership in the cable industry. To make matters worse, now there is a dangerous link between the largest entrepreneurs in the cable industry -- through the Time Warner/Turner Broadcasting merger -- which threatens efforts to increase competition on the information superhighway. Although the Federal Trade Commission (FTC) attempted to limit the involvement of Tele-Communications Inc.'s (TCI) John Malone (more than 9% owner of Time Warner) in the control of Time Warner, this merger unites the owners of cable systems serving approximately one-half of all subscribers and owning many of the most popular cable programming networks. The FTC agrees with our assessment that there are grave dangers associated with this type of merger because the cable

cable programming services of the largest cable companies for three years. See Pub. L. 104-104, 110 Stat. 56 (1996) at Sec. 301(b)(4).

⁸ In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, THIRD ANNUAL REPORT, CS Dkt. No. 96-133, adopted by the FCC Dec. 26, 1996, at para. 130-145 (footnotes omitted).

market is already so concentrated.

The sale of Cable Television Programming Services to MVPDs (Multichannel Video Programming Distributors) in the United States is highly concentrated, . . .

Entry into the relevant markets is difficult, . . .

Entry into the production of Cable Television Programming Services for sale to MVPDs that would have a significant market impact and prevent the anticompetitive effects is difficult. It generally takes more than two years to develop a Cable Television Programming Service to a point where it has a substantial subscriber base and competes directly with the Time Warner and Turner "marquee" or "crown jewel" services throughout the United States. Timely entry is made even more difficult and time consuming due to a shortage of available channel capacity . . .

Entry into the sale of Cable Television Programming Services to households in each of the local areas in which Respondent Time Warner and Respondent TCI operate as MVPDs is dependent upon access to a substantial majority of the high quality, "marquee" or "crown jewel" programming that MVPD subscribers deem important to their decision to subscribe, and that such access is threatened by increasing concentration at the programming level, combined with vertical integration of such programming into the MVPD level.⁹

Unless TCI's additional market consolidating transactions since this merger are not blocked by antitrust and regulatory authorities, the TCI/Time Warner stranglehold on the market will only tighten. TCI announced plans to purchase one third of Cablevision Systems Corp., four months ago, an acquisition which would promise this conglomerate one-third of all cable subscribers (not including TCI's 9% interest in Time Warner, which serves about 19% of cable subscribers). The effect such a transaction would have on the world of sports enterprises should cause supporters of competition pause. This transaction would expand TCI's partial ownership of regional sports channels considerably, by adding Cablevision's Rainbow Media Holdings. The acquisition, which consists of Madison Square Gardens, the New York Knicks, the New York Rangers, and 8 additional regional sports channels would make TCI sports programming empire -- now strong with 14 partial ownerships -- even more formidable.¹⁰ TCI also is attempting to expand its stake in Rainbow by joining with Rupert Murdoch's News Corp. to purchase an additional 40% stake in Rainbow's sports assets.¹¹

⁹ In the Matter of Time Warner Inc., Turner Broadcasting System, Inc., Tele-Communications, Inc., and Liberty Media Corp., FTC File No. 961-0004, Complaint, Sept. 12, 1996 at 6-8

¹⁰ Paul Farhi, "A Sporting Chance to Be No. 1," *Washington Post*, June 24, 1997

¹¹ Mark Robichaux, "Fox-TCI Venture Nears Pact to Buy 40% Of Cablevision Sports for \$850 Million," *Wall Street Journal*, June 20, 1997

Working with TCI, Murdoch appears to be following the lead of Cablevision System Corp.'s Chairman Charles Dolan in combining sports team ownership and control of regional sports channels with a distribution system, to control the price and distribution of popular sports programming:

In the early nineties, John Malone, the president and C.E.O. of TeleCommunications, Inc. (TCI), had begun to follow Dolan's lead, creating a regional network of sports cable channels through a subsidiary called Liberty Media Corporation. It was this ready-made network that Murdoch tapped into when he and Malone, in late 1995, created a joint venture, called Fox/Liberty Sports. . . In fortifying their net of regional channels that feature local games, Murdoch and Malone were betting that viewers care more about seeing their home teams play than watching whatever games are on a national channel. . .

For Murdoch, buying the Dodgers is a vital step in building his two regional Fox Sports West networks in Southern California, and it is also a way to check-mate the now Disney-owned ESPN. Currently, Fox/Liberty Sports has locked up the local cable rights to all six of the professional sports teams in Los Angeles - the Lakers, the Kings, the Clippers, the Dodgers, and the Disney-owned Angels and Mighty Ducks. But in a couple of years, when Fox's rights to those teams expire, ESPN - having missed the opportunity to expand from a national-to a regional-channel business- will almost surely try to start a local cable sports channel, going head on against the local Fox cable channels. The value of the Dodgers to Fox when that moment comes cannot be overestimated. **"Owning the team is a way of making sure you don't lose the rights"**, Peter Barton, the former C.E.O. of Liberty, points out.

The thinking here, of course, is that once you have the rights secured, and you own the channels, you can adopt a more profitable business plan - one that, if unchecked, would mean fewer and fewer games on free TV. . . "Taking control of sports in a market gives them the ability to charge rabid fans to watch games that you and I grew up watching for free." [quote from an unnamed source].

* * *

Within the last two years, Fox Sports has become a co-holder of baseball's national-broadcast television rights and - mainly through Fox/Liberty Sports deals - the holder of local-cable rights of a majority of the teams. Many teams depend heavily on those revenues, and if Fox owned the Dodgers it would be in a position to affect a rival team's competitiveness. Drayton McLane, the owner of the Astros - whose local-cable rights are owned by Fox Sports Southwest - said, "It is absolutely of concern, because it is your business partner who is paying you - and also owns the Dodgers."

* * *

When I asked about the possibility of McLane's voting against the deal, for example, he alluded to the Astros' deal with Fox. "I don't think they have an

alternative", he said. "We're the only regional sports network in town". **Indeed, Fox is already ubiquitous in baseball - with its ownership of the national rights and its dominance of local rights - so the idea of taking a stand to block this deal may, in the end, seem just too quixotic.** And there is also, of course, the factor of the owners' financial self-interest; a price as high as \$311 million for the team and its real-estate holdings obviously raises the value of the other franchises as well.¹²

While The New Yorker focuses on Murdoch's strategy, this business plan clearly adds dramatic market power to John Malone's existing cable empire.

These transactions coincide with a number of other deals between Rupert Murdoch, TCI and Time Warner that illustrate how bumpy the road to competition is getting on the information superhighway. After threatening to launch a competitive challenge to the cable industry by joining forces with EchoStar's satellite television business, Murdoch abandoned EchoStar in return for a share of the cable-controlled satellite system (Primestar) and carriage of his Fox News Channel on Time Warner systems.¹³ If this transaction is approved by the Commission and antitrust authorities, the cable industries' Primestar partners -- TCI, Time Warner, Comcast, US West (formerly Continental Cablevision) and Cox -- will control massive satellite capacity. This capacity could have been used to offer competition to the cable industry, but instead the cartel of cable heavyweights will be in a position to use this satellite capacity to preserve their monopoly.

This cable cartel has transformed one-time renegade Rupert Murdoch into a full partner, thanks to the overwhelming market power of the nation's largest cable companies. This spring, Rupert Murdoch's News Corp. proposed a major competitive assault on the cable industry. As Mr. Murdoch described the venture to the Senate Commerce Committee on April 10 of this year:

. . . DBS still has not made major inroads against cable. Why? For three major reasons: the minimum \$700 up-front outlay required for current DBS services is too expensive; current DBS services do not easily or economically serve multiple TV sets in the home; and the DBS program package does not include local broadcast stations. . .

Subject to merger approval, SKY plans to come to market this Fall with a service that does overcome these limitations. . .

The up-front costs for SKY subscribers will include only around fifty dollars to purchase the dish itself, plus a fifty dollar refundable deposit per converter box and a reasonable installation charge. With that, consumers can receive hundreds of channels of digital pictures with CD quality sound.

¹² Connie Bruck, "The Big Hitter," *The New Yorker*, December 8, 1997 at 88-93 (emphasis added)

¹³ John Lippman and Mark Robichaux, "News Corp. Wins Tentative Pact to Join Cable Firms in Satellite-Dish TV Service," *Wall Street Journal*, May 27, 1997

Finally, SKY will overcome the most difficult hurdle. We will bring viewers their local broadcast stations as a part of the basic package. . .

Charlie Ergen and I are truly excited about the pro-competitive service we want to bring to market in a few short months. **For the first time, when consumers choose between cable and DBS offerings, the choice before them will be between two equivalent service to multiple sets in the home and equivalent sign-upcosts. . .**

. . . SKY is willing to risk a three billion dollar capital investment to bring consumers a better choice now. . .

If you give the legal authority to compete, the rest is up to us.¹⁴

Instead of SKY, consumers are left with another broken promise from the industry giants. The cable industry did not take kindly to Murdoch's competitive efforts and launched a counterattack, that transformed and co-opted the threat:

As the cable industry descends on New Orleans today for its annual trade show, it is launching a legal, political and advertising assault aimed at blocking or at least slowing down the new service, reviled in cable circles as "the Death Star." Although Sky is scheduled to begin operating next year, it must clear regulatory hurdles involving market concentration, foreign ownership and copyright violations. The cable industry plans to exploit all these in a bid to topple Sky. The cable industry will marshal its forces against rival Rupert Murdoch's plan to beam hundreds of TV channels -- including local TV stations -- into peoples' homes via satellite, cable giant Ted Turner declared yesterday.

"We're going to make it as tough for him as we possibly can. Kind of like the Russian army did with the German army," said Mr. Turner, Time Warner Inc. vice chairman. . .¹⁵

The Bureau of Labor Statistics reports that since passage of the 1996 Act, cable rates shot up about 14% (compared to an inflation rate of 3.8%).¹⁶ This is more than three times the rate of inflation, and 50 percent higher than where the FCC itself projected rates would be at this time.¹⁷ The FCC has also found that cable subscribership has expanded as consumers cannot find

¹⁴ Statement of Rupert Murdoch before the Senate Commerce Committee on Multichannel Video Competition, April 10, 1997 (emphasis added)

¹⁵ Jeannine Aversa, Associated Press, "Cable Industry Takes Aim at Murdoch's Satellite," *Washington Times*, March 20, 1997

¹⁶ Bureau of Labor Statistics, Consumer Price Index, urban areas, cable services and all goods, February 1996 through August 1997

¹⁷ Petition of Consumers Union, op. cit.,

a lower priced alternative:

In all but a few local markets for the delivery of video programming, the vast majority of consumers still subscribe to the service of a single incumbent cable operator. The resulting high levels of concentration, together with impediments to entry and product differentiation, mean that the structural conditions of markets for the delivery of video programming are conducive to the exercise of market power by cable operators. . .

During 1996, the cable industry's total basic subscribership, total homes passed, basic penetration, and premium channel subscriptions have reached all-time highs. . . Subscribership grew from a total of 59.7 million at the end of 1994 to 62.1 million at the end of 1995, a 4.0% increase. . . This increase in penetration is the second largest annual increase since 1977. According too at least one analyst, industry subscribership appears to be growing at approximately a 3% growth rate during 1996.¹⁸

When seeking reduced regulation during Congressional consideration of the 1996 Act, the cable industry claimed that potential competition would prevent the excessive rate increase consumers have been experiencing:

But he [Mr. Anstrom] says that the looming threats of imminent competition will keep cable operations honest.

"If I'm running a variety store, and I learn that WalMart is buying a parcel of land and they'll open in 18 months, what am I going to do -- jack up my prices and alienate my customers? No Way," Mr. Anstrom says.¹⁹

Apparently, no "WalMarts" are anywhere in sight to challenge the cable "variety store" monopoly.

The cable industry and the Commission's former chairman blame rate increases on the rising cost of programming.²⁰ What the cable industry and former Chairman Hundt fail to mention, however, is the fact that eight of the thirteen most popular cable networks are substantially owned by cable operators -- see Table 1, and a substantial portion of overall cable programming is owned by the largest cable companies -- see Table 2. It appears that the largest cable companies, knowing that programming costs can be passed through to consumers and competitors with the FCC's relaxed regulations, have made programming their profit center. The FCC points out that, while the price of regulated cable programming shot up 19% in 1995, the price of premium channels (including the most expensive movies) and broadcast channels (the

¹⁸ THIRD ANNUAL REPORT, op. cit., at para. 12-14 and para. 128 (footnotes omitted)

¹⁹ Mark Robichaux, "Cable Industry Says New Rivals Obviate Rules," *Wall Street Journal*, April 3, 1995.

²⁰ Rebecca Cantrell, "TCI Reports Rise In Cash Flow," *Rocky Mountain News*, March 4, 1997; and David Lieberman, "TCI to Boast Cable TV Rate," *USA Today*, March 13, 1997; statement of Reed Hundt, op.cit.

most expensive, popular network programming) rose only 2%.²¹ However, the Commission has done nothing to investigate this programming sleight of hand.²² In addition, BLS data show that cable rates are rising much faster than the cost of programming (see Figure 2). And neither the cable industry nor the FCC note that cable has a new lucrative source of revenue – advertising brings about \$1 billion more each year, more than \$7 billion in total, to cable operators.²³

What is most troubling is the Commission's apparent change of heart in measuring what "competitive" market factors determine reasonable rates. While the FCC's earlier rate regulation decisions state "that systems in the overbuild [i.e., head-to-head competition] sample provide the most informative data with regard to estimating reasonable rates,"²⁴ this week's FCC Report on Cable Industry Prices provides NO information on head-to-head competition in either the press release or body of the Report!²⁵ After digging through a confusing and potentially misleading maze of information, anyone who stumbles upon Attachment D-5 will find the most important information that led the Commission to reduce cable rates in 1993-94. Attachment D-5 shows that where cable faces head-to-head competition (from another cable company, telephone company or municipal system), rates are still about \$3/month lower than everywhere else.²⁶ In percentage terms, rates are 15-20% lower where head-to-head competition exists. Originally, this was the basis for the Commission's benchmark regulations that reduced cable rates. Now, it is hidden in an attachment and given no recognition in the Report's conclusion.

Preoccupied with numerous, time constrained proceedings designed to open the local and long distance telephone markets to more competition, the FCC has failed to address the excessive video concentration and monopolistic pricing its own analyses identify. **Since passage of the 1996 Act, cable rates are rising at a faster rate than ever before (see Figure 1).** It is therefore time for the Commission to take action to ensure reasonable rates, prevent monopolistic practices and promote vigorous competition for cable services.

III. SLOW GROWTH OF COMPETITION

²¹ THIRD ANNUAL REPORT, op. cit., at para. 19.

²² In echoing cable industry claims about programming prices, former FCC Chairman Hundt presented charts to the House Judiciary Committee that are inconsistent with the Commission's own analysis of cable industry pricing and misleading to the public. These charts appear to show that cable rates are higher in markets that are competitive than in monopoly markets, even though more detailed FCC analyses show just the opposite. Rates tend to be 12-20 percent lower where competition exists. These charts also appear to disregard programming discounts from the "rate card" in evaluating trends in programming prices, only evaluate costs for a small group of program networks, and fail to consider any qualitative differentials among cable channels. Contrary to the FCC's charts, Figure 2 shows that after passage of the 1996 Act, cable rates shot up much faster than input costs – like programming – that cable operators incur. See also statement of Reed Hundt, op. cit.

²³ Paul Kagan Associates, Inc., Cable TV Financial Databook, 1997.

²⁴ In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Second Order on Reconsideration FCC Dkt. No. 92-266 at para. 29.

²⁵ FCC Report on Cable Industry Prices, MM Dkt. No. 92-266, Dec. 15, 1997.

²⁶ Id. At Attachment D-5

One of the biggest disappointments so far, under the 1996 Act, has been the retreat of the local telephone companies from their previous desire to compete against the cable industry. After years of clamoring to offer competition to the cable industry, the local telephone companies -- fully unshackled by the 1996 Act to enter the video market through four different streamlined approaches²⁷ -- have done more backtracking than competing against cable. While Ameritech and BellSouth have made modest efforts to provide video services, the much ballyhooed Bell company Tele-TV initiative went from a major potential competitor to the dust-heap last year:

Sixteen months ago, Mr. Grushow agreed to take over the programming arm of Tele-TV, a television joint venture owned by Bell Atlantic, Nynex and Pacific Telesis. The three companies had set a lofty goal: to develop an interactive alternative to cable television . . .

The Baby Bells originally planned to roll-out Tele-TV to 30 million homes in six of the nation's seven largest markets by the end of the century . . .

But after repeated delays in technology and a tectonic shift in regulations, the Baby Bells now admit that getting into television is only one of several priorities. Having completed his design for Tele-TV, Mr. Grushow wonders how many people will ever see it.²⁸

Tele-TV, the high-profile programming alliance owned by three Baby Bells, has been ordered to slash its budget, slow down hiring and delay development of interactive fare -- ostensibly the reason the unit was formed -- for at least another year.²⁹

Bell Atlantic Corp., Nynex Corp. and Pacific Telesis Group are taking steps to shut down Tele-TV, . . . they have basically abandoned their hopes of leading the way on development of the next generation of interactive fare amid technical difficulties, rising costs and vast changes in the market.³⁰

The Bell company pull-back from aggressive video competition has also occurred in the wireless market. The FCC found that the only operational wireless system owned by a local phone company is a 42,000 subscriber system in California.³¹ Recently Bell Atlantic abandoned

²⁷ Pub. L. 104-104, 110 Stat. 56 (1996); see also ANNUAL REPORT, op. cit., at para. 67-69.

²⁸ Mark Landler, "Baby Bells' TV Developers Are on Hold and Frustrated," *New York Times*, August 5, 1996

²⁹ Leslie Cauley, "Baby Bells Push the Pause Button Again on Tele-TV Interactive Unit," *Wall Street Journal*, June 7, 1996

³⁰ Leslie Cauley, "Bell Atlantic, Nynex, PacTel to Close Tele-TV," *Wall Street Journal*, December 6, 1996

³¹ THIRD ANNUAL REPORT, op. cit., at para. 72

a digital trial in Fairfax, Va.,³² and in conjunction with Nynex, appears to have bailed out of wireless altogether:

Bell Atlantic Corp. and Nynex Corp. said they plan to "suspend" their agreement with a small wireless cable operator, CAI Wireless Systems Inc., . . . The move sets the stage for the two Bells to bail out of that business altogether as they pursue other opportunities.

The Friday announcement amounted to an about-face for Bell Atlantic and Nynex, which last year had hailed their pact with CAI as instrumental to speeding delivery of video entertainment and information service to millions of customers in the Northeast.³³

It is interesting that most of the Bell companies now believe they are better off investing their money in the long-term opportunity to move into the long distance business -- even though not a reality until statutory guidelines are met -- instead of the immediate chance to compete with cable. For example, at the time they announced their proposed merger with Nynex, Bell Atlantic officials expressed relief that their previous "pact" with cable giant TCI "foundered," as market analysts described the logic for the Bell companies to pull back from a video competition strategy:

"The reason that long-distance carries the day over television is that it is just so easy," said William C. Bane, a telecommunications consultant at Merger Management Consulting in Washington. "The problem with them getting into cable TV is that they don't have the plant," he added, referring to the miles of high-capacity cable typically required for video networks.³⁴

Despite aggressive past talk about competing in the telephone business, the cable industry has retreated to its cushy video monopoly. Almost exactly two years ago, as Congress began deliberations on the Telecommunications Act, the Senate Commerce Committee received testimony from the cable industry stating unequivocally that ". . . cable television companies are the most likely competitors to local phone monopolies . . ."³⁵ The cable industry crowned itself "King of the Competition Sweepstakes" in telecommunications, and lobbied Congress to dump or relax cable rate regulation to increase cash flow and trigger competition. However, it appears Congress was sold a bill of goods.

³² Id., at fn. 224

³³ Leslie Cauley, "Bell Atlantic, Nynex Plan to Suspend Agreement With CAI Wireless Systems," *Wall Street Journal*, December 16, 1996

³⁴ Mark Landler, "A Sticking-to-Their-Knitting Deal," *New York Times*, April 23, 1996

³⁵ Statement of Decker Anstrom, National Cable Television Association Before the Committee on Commerce, Science, and Transportation U.S. Senate, March 21, 1995, S. Hrg. 104-216 at 5,8, and 25

If you look at the entire structure, the competitive theory of the broad legislation in front of this committee, the theory is that you are going to allow the Regional Bell companies to move into manufacturing, information services, burglar alarm services, cable, other areas, and that their potential for anticompetitive behavior is going to be checked because they are going to have competition. And then you look around, and who is going to provide that competition?

And I would submit to this committee it is us. We are the other wire, and if we do not have the financial and investment environment to make those investments, those tens of billions of dollars, then the end result is that this committee and this Congress will have opened up a Pandora's box in terms of extending the regional phone companies' monopolies, and you will never close it again.³⁶

The relaxed regulation of cable rates³⁷ brought the cable industry into a strong cash-flow position, but the competition consumers were promised was not unleashed. Instead, the largest cable companies have virtually abandoned immediate efforts to compete with local telephone companies. For example,

Time Warner has already indicated it plans to substantially scale back both Orlando (futuristic Full Service Network) and its ambitious plans for the telephone business, a move that is expected to save the company about \$100 million next year in capital expenditures. "Our strategy to approach the telephone business is something we are reassessing," a Time Warner spokesman confirmed.³⁸

Shockingly, the most aggressive cable CEO, John Malone, has announced a full retreat from telephone competition:

John Malone, chief of the nation's biggest cable company, Tele-Communications Inc., has a stunning admission to make. His widely hailed vision for TCI's future as a multimedia powerhouse straddling television, telephones and the Internet, isn't working.

It was too ambitious, over hyped, and impossible to carry out on schedule, he says . . . "The company got overly ambitious about the things it could do . . ."

He is abruptly revising his longstanding promise that TCI was set to become the powerful lord of the new information superhighway, using cable to deliver phone service, the Internet, and other futuristic interactive goodies.

³⁶ Statement of Decker Anstrom, op.cit., at 115 (emphasis added)

³⁷ THIRD ANNUAL REPORT, op. cit., at 11-16

³⁸ Eben Shapiro, "Time Warner Expands Plans For Cost Cuts," *Wall Street Journal*, October 10, 1996

"If you read our annual report last year, you'd think we're one-third data, one-third telephone and one-third video entertainment, instead of 100% video entertainment and two experiments," he says . . .

With the zeal of a convert, he has a new sermon. The old cable industry is a perfectly good business to be in, and shouldn't be penalized for failing to deliver on all its promises, he says. Moreover, telephone companies have retreated as video competitors to focus on long-distance business.

"Right now, we've got zero revenue from residential telephone service, diminishing revenue from high-speed Internet, and \$6 billion in revenue from video entertainment," he says.³⁹

It is no wonder that the telephone companies have lost their zeal to attack the cable market and compete aggressively for that business. Cable companies show no sign of taking away a significant portion of the local telephone companies' core business.

Because the telephone industry has been retreat, the biggest source of potential competition to cable could come from the growing satellite industry. But, prices for necessary equipment to put satellite TV in to the home are substantially above cable rates, and the satellite systems still cannot offer local broadcast stations. As a result, satellite remains only a limited "high end" alternative to cable. The FCC's competition report suggests the view that satellite TV provides a poor counterweight to constrain cable pricing.⁴⁰ Even key players from the cable industry admit that Direct Broadcast Satellite is not cost competitive with cable:

TCI spokesman Bob Thomson asserted yesterday that even with the increase, the company's prices are still a bargain compared with DBS.

At a news conference, the company displayed charts showing that the cost of service provided by one of its typical systems is about half that of the three leading DBS services, based on roughly equivalent program packages.

The widest disparity was between TCI's price and that of DirecTv/USSB, which is the leading DBS provider with more than 2 million customers . . .

Despite its growth, DBS services remain a higher-priced option for many, if not most, of cable's 65 million customers, particularly after factoring in the cost of equipment and installation. What's more, DBS hasn't completely displaced cable for avid viewers, since many DBS subscribers maintain basic cable service to receive local stations, which DBS services don't offer yet.⁴¹

³⁹ Mark Robichaux, "Malone Says TCI Push Into Phones, Internet Isn't Working for Now," *Wall Street Journal*, January 2, 1997 (emphasis added)

⁴⁰ THIRD ANNUAL REPORT, op. cit., at para. 38 and para. 125-128.

⁴¹ Paul Farhi, "Biggest Cable Operation To Raise Rates 7% in '97," *Washington Post*, March 14, 1997.

CONCLUSION

Consumers Union believes that the only immediate way to protect consumers from excessive cable rate increases is for the FCC put a lid on prices and block monopolistic practices until effective competition develops in the video market. Without aggressive intervention in the increasingly monopolistic cable market, the competitive goals of the 1996 Telecommunications Act will never be achieved, and consumers will face spiraling cable rates without a reasonable choice of alternative service providers.

The Consumers Union petition to the Commission for an immediate freeze on cable rates is a necessary response to an industry which is out of control. We hope the FCC will act to make sure that consumers are not gouged by the cable cartel. A simple freeze on spiraling cable TV rates will save consumers more than one billion dollars over the next year. And aggressive FCC action to prevent anticompetitive cable industry practices will begin to promote the competition that Congress and consumers have been seeking for many years.

TABLE 1
Vertical Integration: Top Fifteen Programming Services by Ratings
By Prime Time Rating

Rank	Programming Service	MSO with Ownership Interest ¹
1	TNT	TCI, Time Warner (Others have 5% or less)
2	TBS	TCI, Time Warner (Others have 5% or less)
3	ESPN	None
4	USA Network	None ²
5	Lifetime	None
6	Cartoon Network	TCI, Time Warner (Others have 5% or less)
7	Arts & Entertainment	None
8	The Family Channel	TCI
9	Discovery	TCI, Cox
10	TNN (The Nashville Network)	None
11	CNN	TCI, Time Warner (Others have 5% or less)
12	The Learning Channel	TCI, Cox
13	BET	TCI, Time Warner
14	Sci-Fi Channel	None
15	The Weather Channel	None

Sources: Paul Kagan Associates, Cable TV Programming, Prime-Time Ratings, July 1996, at 10.
(Reprinted from ANNUAL REPORT, op. cit., at Appendix G, Table 1)

¹ See Table 5 for ownership percentages

² USA Network and Sci-Fi Channel are owned by Viacom which sold its cable systems to TCI in 1996.

TABLE 2

MSO Ownership in National Programming Services

Programming Service	Launch Date	Ownership Percentage
Action Pay-Per-View	Sept-90	TCI (22) Time Warner (15)
AMC	Oct-84	Cablevision Systems (75)
Animal Planet	Jun-96	TCI (49), Cox (24.7)
BET	Jan-80	TCI (22) Time Warner (15)
BET on Jazz	Jan-96	TCI (22) Time Warner (15)
The Box	Dec-85	TCI (5)
Bravo	Feb-80	Cablevision Systems (50)
Cartoon Network	Oct-92	Time Warner (100)
Catalog 1	Apr-94	Time Warner (50)
Cinemax	Aug-80	Time Warner (100)
CNN	Jun-80	Time Warner (100)
CNN International	Jan-95	Time Warner (100)
CNNfn (The Financial Net.)	Dec-95	Time Warner (100)
Comedy Central		Time Warner (50)
Court TV	Jul-91	TCI (33.3) Time Warner (33.3) Continental (33.3)
The Discovery Channel	Jun-85	TCI (49) Cox (24.6)
Encore	Apr-91	TCI (90)

Programming Service	Launch Date	Ownership Percentage
Encore Love Stories	Jul-94	TCI (90)
Encore Westerns	Jul-94	TCI (90)
Encore Mysteries	Jul-94	TCI (90)
Encore Action	Sept-94	TCI (90)
Encore True Stories and Drama	Sept-94	TCI (90)
Encore WAM! America's Youth Network	Sept-94	TCI (90)
The Family Channel	Apr-77	TCI (20)
Faith & Values	Jun-84	TCI (49)
FIT TV	Oct-93	TCI (20)
fX	Oct-94	TCI (50)
FXM	Oct-94	TCI (50)
Germs International Television	Apr-93	Cox (50)
The Golf Channel	Jan-95	Continental (20.2), Comcast, Cablevision Systems, Adelphia
Great American Country	Dec-95	Jones (**)
HBO	Nov-72	Time Warner (100)
HBO 2	Dec-75	Time Warner (100)
HBO 3	Oct-93	Time Warner (100)
Headline News	Jan-82	Time Warner (100)
Home Shopping Network	Jul-85	TCI (80)

Programming Service	Launch Date	Ownership Percentage
Home Shopping Network II	Sept-86	TCI (80)
Independent Film Channel	Sept-94	Cablevision Systems (50)
The International Channel	Jul-90	TCI (45)
Into Television ¹	Sept-94	TCI (100)
Jones Computer Network	Sept-94	Jones (81)
The Learning Channel	Nov-80	TCI (49) Cox (24.7)
Mind Extension University	Nov-87	Jones (66)
Much Music USA	Jul-94	Cablevision Systems (50)
Newsport	Feb-94	Cablevision Systems (25)
Outdoor Life Channel	Jul-95	Cox (41), Continental (23), Comcast (22.5)
Ovation: The Fine Arts Network	Apr-96	Time Warner (**)
Prime Deportiva	Mar-95	TCI (100)
Prime Network	Jun-93	TCI (33) Cablevision Sys. (25)
Product Information Network	Apr-94	Cox (50) Jones (**) Adelphia (**)
Q2	Sept-94	Comcast (57.4) TCI (42.6)
Request Television	Nov-85	TCI (40)
Request 2	Jul-88	TCI (40)
Request 3-5	Sept-93	TCI (40)

¹ On December 1, 1995, tv! Network became Into Television.

Programming Service	Launch Date	Ownership Percentage
Sega Channel		TCI (33), Time Warner (33)
Speedvision	Dec-95	Cox (39.0) Continental (22.1)
Starz!	Feb-94	TCI (49.9)
The Sunshine Network	Mar-88	Cox(5.3)
TBS		Time Warner (100)
Television Food Network	Nov-83	Continental (15), Scripps- Howard (13.17), Cox (1.9) Adelphia, C-TEC (**)
TNT	Oct-88	Time Warner (100)
Turner Classic Movies	Apr-94	Time Warner (100)
Viewers Choice	Nov-85	Cox (20), Time Warner (17) Continental (12), Comcast (11), TCI (10)
Viewers Choice: Hot Choice	Jun-86	Cox (20), Time Warner (17) Continental (12), Comcast (11), TCI (10)
Viewers Choice: Continuous Hits 1,2,3	Feb-93	Cox (20), Time Warner (17) Continental (12), Comcast (11), TCI (10)

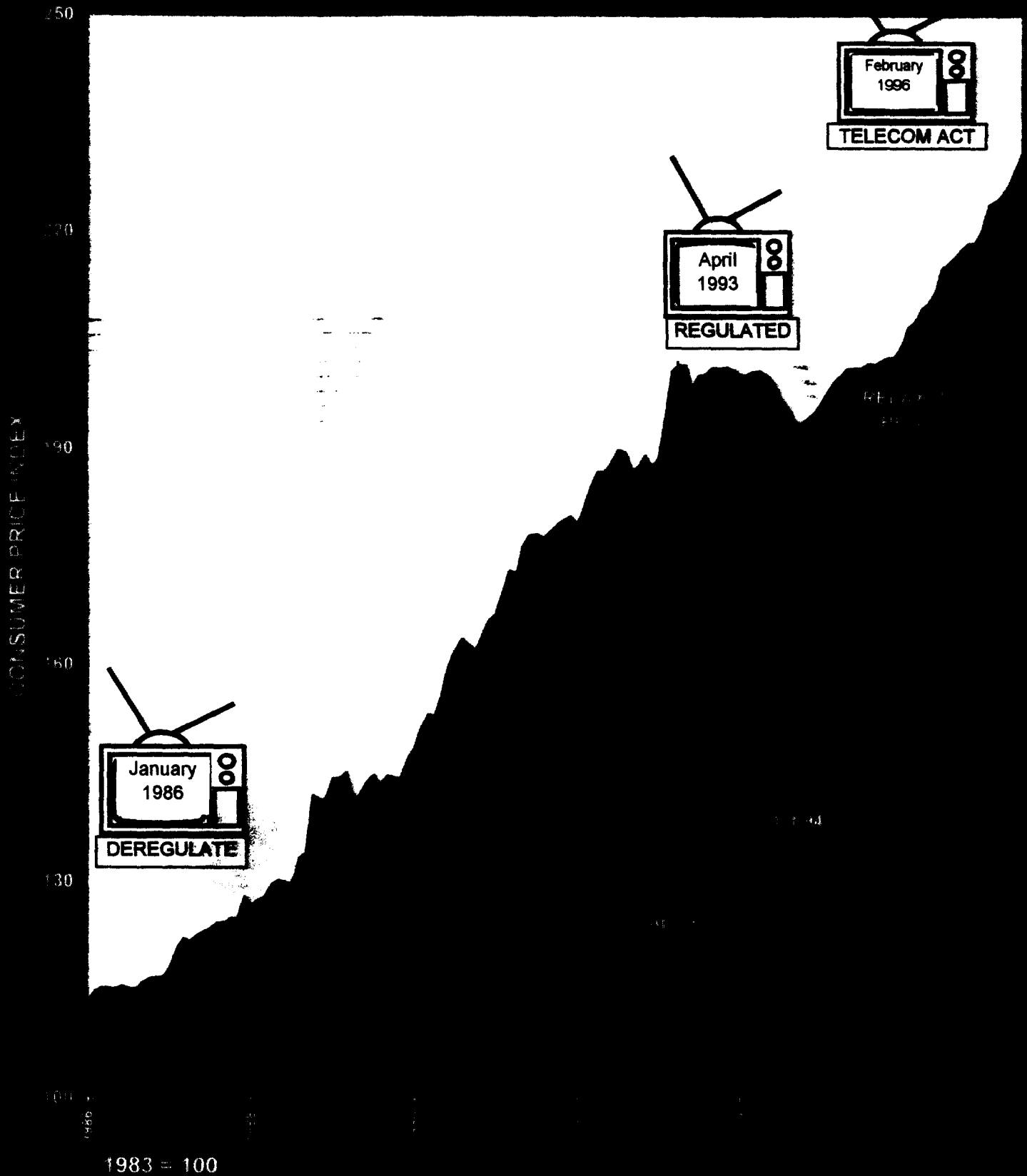
* Denotes ownership percentage of less than 5%.

** Ownership percentage not available

Source: Annual Reports of various MSOs.

(Reprinted from ANNUAL REPORT, op. cit., at Appendix G, Table 7)

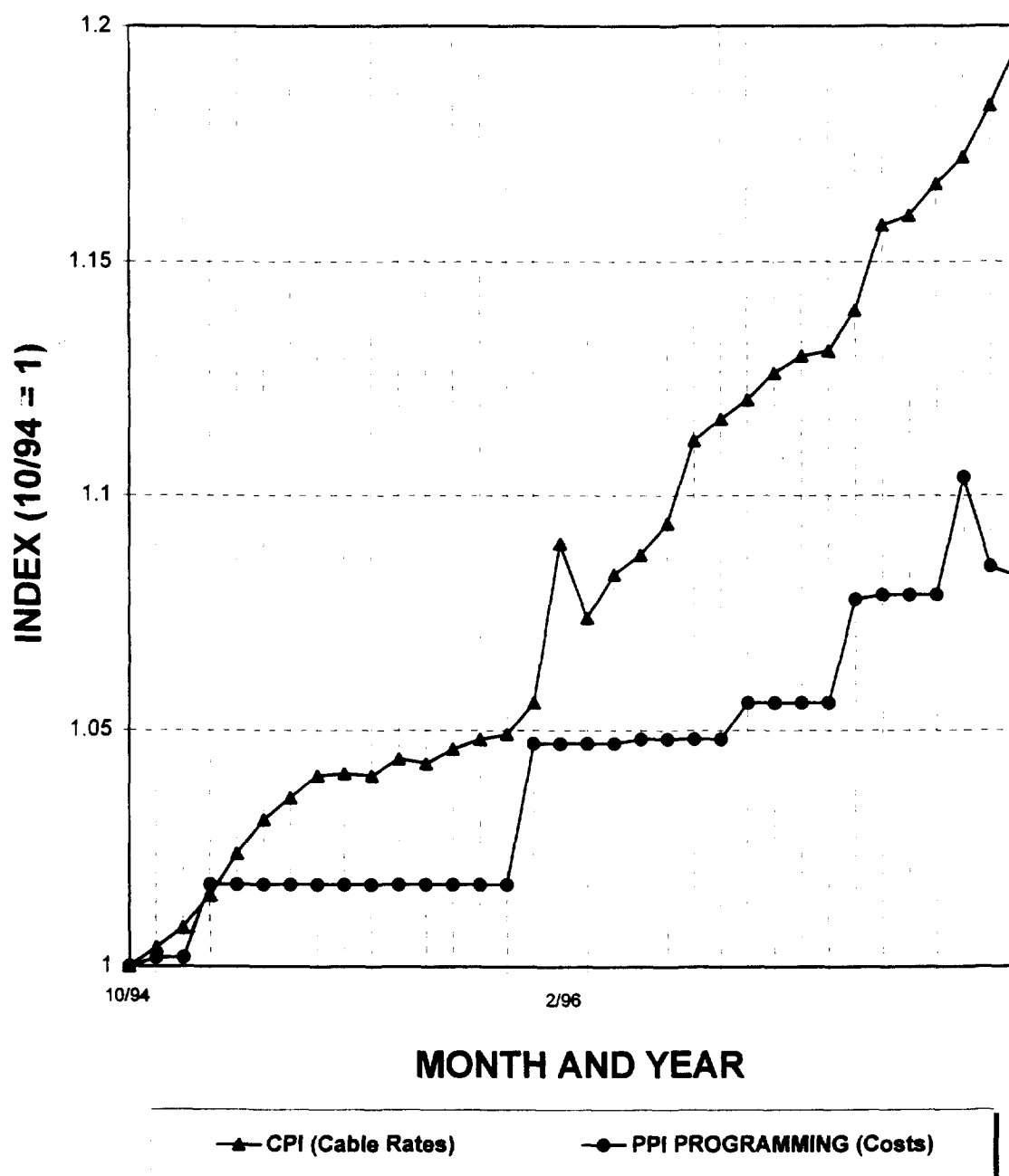
CABLE RATES SINCE DEREGULATION IN THE 1980s



SOURCE: BUREAU OF LABOR STATISTICS

FIGURE 2

CABLE RATES COMPARED WITH PROGRAMMING COSTS



Source: Bureau of Labor Statistics



Publisher of Consumer Reports

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Gene Kimmelman
Co-Director
Washington, DC Office of Consumers Union,
Publisher of *Consumer Reports*

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Gene Kimmelman is co-director of the Washington, DC office of Consumers Union, publisher of *Consumer Reports* magazine. As co-director, he is responsible for management of the office as well as oversight of all federal advocacy issues. Mr. Kimmelman has extensive expertise in a wide variety of public policy issues, including telecommunications, cable television, product liability, antitrust law and health care.

Mr. Kimmelman is a recognized expert on deregulation and consumer protection issues, particularly in the area of telecommunications. He was the lead consumer advocate on the omnibus Telecommunications Act of 1996 and was successful in seeing significant consumer protections added to the telecommunications deregulation legislation. Mr. Kimmelman is widely quoted on telecom issues in a variety of publications including the *New York Times*, *Wall Street Journal* and *Washington Post*. He frequently is interviewed for network and cable television news programs.

Prior to joining Consumers Union, Mr. Kimmelman served for two years as chief counsel and staff director for the Antitrust Subcommittee of the Senate Judiciary Committee. Prior to that, he was legislative director for the Consumer Federation of America where, during his 10-year tenure, he directed CFA's legislative, regulatory and judicial intervention program. Mr. Kimmelman began his career as a consumer advocate and staff attorney for Public Citizen's Congress Watch.

Mr. Kimmelman is a Phi Beta Kappa, Magna Cum Laude graduate of Brown University. He studied in Denmark as a Fulbright Fellow at Copenhagen University's graduate program on the public sector. He received his law degree from the University of Virginia and was the recipient of the University's Fortsman Fellowship in 1980.

Consumers Union is headquartered in New York and has advocacy offices in Washington, DC, California and Texas. The advocacy offices work to represent consumers in the executive, legislative and judicial branches of government.

Consumers Union, publisher of *Consumer Reports* magazine, is an independent nonprofit testing and information organization serving only the consumer. Consumers Union is a comprehensive source of unbiased advice about products and services, personal finance, health, nutrition, and other consumer concerns. Since 1936, the organization's mission has been to test products, inform the public and protect consumers.

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1997

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**Statement of Gene Kimmelman
Consumers Union of the United States**

EXECUTIVE SUMMARY

It is time for the FCC to set a new course for the marketplace. Unless the FCC imposes a meaningful lid on cable rates and attacks the root cause of monopolistic excesses, consumers will face skyrocketing prices without adequate competitive alternatives

Cable bills are sky-high. The Bureau of Labor Statistics reports that since passage of the 1996 Act, cable rates shot up about 14 percent, compared to an inflation rate of 3.8 percent. *More than three times the rate of inflation.*

Consumers cannot find a lower priced alternative. Prices for necessary equipment to put satellite TV in the home are substantially above cable rates, and the satellite systems still cannot offer local broadcast stations. With about 62.1 million households subscribing to cable TV, the cable industry's penetration is at an all-time high, and still growing at a rapid clip.

The road to competition on the information superhighway has been bumpy.

The FCC's own market analyses show a few large cable companies dominate the ownership and distribution of cable programming and market entry is hard. Time to develop a Cable Television Programming Service: more than 2 yrs.

Available channel capacity: short supply.

Access to high quality programming: threatened by concentration at the programming level combined with vertical integration of such programming into the Multichannel Video Programming Distributors level.

The profit center: programming. Eight of the 13 most popular cable networks are substantially owned by cable operators who know costs can be passed onto consumers and competitors with the FCC's relaxed regulations. There is an ongoing bid to control the price and distribution of popular sports programming by combining sports team ownership and control of regional sports channels with a distribution system.

Industry Exaggerates. While the price of programming is going up, BLS shows that cable rates are rising twice as fast as programming costs.

Industry Omits. The flip side of programming expenses is the increased audience and ad revenue it generates. The cable industry has been adding about \$1 billion each year in greater ad revenue, bringing in more than \$7 billion in 1996 alone.

It appears that Congress was sold a bill of goods. The relaxed regulation of cable rates brought the cable industry into a strong cash-flow position, but the competition consumers were promised was not unleashed. Cable, telephone and satellite companies exaggerated their desire and willingness to compete. The largest cable companies have virtually abandoned immediate efforts to compete with local telephone companies, preferring to retreat to its cushy video monopoly.

Local telephone companies have done more backtracking than competing against cable.

The Bell Cos. have also pulled back from competition in the wireless market. A cartel of cable heavyweights transformed a would-be competitor into a full partner who is positioned to use satellite capacity to preserve their monopoly.

It's time for aggressive intervention. The competitive goals of the 1996 telecommunications act will never be achieved without action by the FCC. The Consumers Union Petition to the Commission for an immediate freeze on cable rates is a necessary response to an industry which is out of control.

The cost of not acting? \$1 billion. A simple freeze on spiraling cable TV rates will save consumers more than one billion dollars over the next year. It is time for the FCC to get stand up to the pattern of anti-competitive behavior by the cable industry. It is time to foster the competition that Congress and consumers have been promised.

"The FCC has virtually abandoned all efforts to police market abuses or challenge inflated cable TV rates. It appears that relaxed regulation has resulted in substantially higher rates and increased concentration of ownership.... We hope the FCC will act to make sure that consumers are not gouged by the cable cartel."

*-- Gene Kimmelman
Co-Director, Washington Office
Consumers Union*